

REPORT OF EXAMINATION
SAFECO NATIONAL LIFE INSURANCE
COMPANY

Redmond, Washington

December 31, 2000

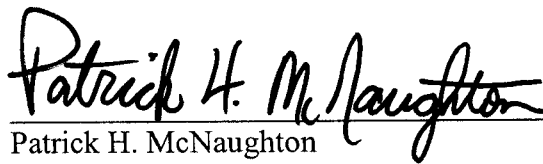


States Participating:

Washington
Delaware
Nevada

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify that I have reviewed the attached Report of Examination of the financial condition and affairs of SAFECO INSURANCE COMPANY OF AMERICA of Seattle, Washington, as of December 31, 2000.



Patrick H. McNaughton
Chief Examiner

9-11-03

Date

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SALUTATION

Seattle, Washington
August 27, 2003

The Honorable Alfred W. Gross
Commissioner, Commonwealth of Virginia
Chair, NAIC Financial Condition (EX)
Committee
NAIC Secretary, Southeastern Zone
PO Box 1157
Richmond, VA 23218

The Honorable John Morrison
Commissioner, Montana Department of Insurance
NAIC Secretary, Western Zone
840 Helena Avenue
Helena, MT 59601

The Honorable Susan F. Cogswell
Commissioner, Connecticut Dept. of
Insurance
NAIC Secretary, Northeastern Zone
PO Box 816
Hartford, CT 06142-0816

The Honorable Mike Kreidler
Commissioner, Washington State Office of
Insurance Commissioner
5000 Capitol Boulevard
PO Box 40255
Olympia, WA 98504-0255

Dear Commissioners:

In accordance with your instructions and in compliance with the statutory requirements of Chapter 48.03 of the Revised Code of Washington (RCW), an Association examination was made of the corporate affairs and financial records of the

SAFECO NATIONAL LIFE INSURANCE COMPANY
of
Redmond, Washington

hereinafter referred to as the “Company” or “SAFECO National”, at its home office located at 5069 154th Place NE, Redmond, Washington 98052.

As of December 31, 2000, the Company’s in-force business consisted of 3,852 ordinary life insurance policies. The Company wrote no new business during the five-year period under review. The Company was licensed in thirty-nine of the fifty states and the District of Columbia. A listing of the Company’s affiliates and the Company’s relationship as a member of an insurance company holding system is included in this Report of Examination under the caption “AFFILIATED COMPANIES”. The Company was under the control of and managed by a Board of Directors. Officers were appointed by the Board of Directors to operate the Company. The Company had no reinsurance transactions during 2000.

The last examination was as of December 31, 1995. The following Report of Examination is respectfully submitted showing the condition of the Company as of December 31, 2000.

SCOPE OF EXAMINATION

Per RCW 48.03.010, the examination covered the five-year period from January 1, 1995 through December 31, 2000. The Company was last examined as of December 31, 1995 by examiners representing Washington, Delaware and Ohio. On April 19, 2001, an Association Examination was called to begin on June 4, 2001. Insurance examiners from the states of Washington, Delaware and Nevada conducted the current examination concurrently with the Association Examination of five other companies domiciled in Washington – SAFECO Insurance Company of America, General Insurance Company of America, First National Insurance Company of America, SAFECO Surplus Lines Insurance Company, and SAFECO Life Insurance Company. The Southeastern and Midwestern Zones of the National Association of Insurance Commissioners (NAIC) were invited to participate in the examination but elected to decline.

A December 31, 2000 examination of SAFECO National Insurance Company was conducted concurrently by the Missouri Insurance Department. December 31, 2000 examinations of SAFECO Insurance Company of Illinois and its subsidiary, Insurance Company of Illinois, were conducted concurrently by the Illinois Insurance Department.

The examination of the Company was conducted in accordance with the laws of the state of Washington contained in Title 48 RCW and regulations contained in Title 284 Washington Administrative Code (WAC) and the examination procedures prescribed by the NAIC Financial Condition Examiner's Handbook.

Corporate records and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. Comments on any adverse findings that are applicable to the current examination are included in the "INSTRUCTIONS", "COMMENTS AND RECOMMENDATIONS" and "ACCOUNTS AND RECORDS" sections of this report.

INSTRUCTIONS

The examination disclosed the following issues that require Company action:

1. Inadequate Accounts and Records

Our examination of the Company disclosed numerous areas in which the Company's accounts and records were found to be deficient, insufficient, or inaccurate to provide for and ensure full and adequate disclosure. The Company is instructed to comply with RCW 48.05.280 which requires the Company to keep full and adequate accounts and records of

its assets, obligations, transactions and affairs. The results of the examination disclosed the following insufficiencies, errors, and inadequacies:

- a) The results of our examination disclosed numerous bank accounts, within the Company and the SAFECO Group, that were not reconciled on a timely basis. As of mid-2001, within the SAFECO Group of companies, there were over 9,500 "variances" between the bank statement balances and the G/L balances, many of which had to be corrected by entries to the G/L. The variances totaled over \$1,000,000,000, and they were comprised of overstatements and understatements which resulted in an approximate net debit of \$300,000,000.

When this was brought to the attention of the Company during the examination, the Company took immediate action and brought in an outside consultant to assist in reconciling these accounts. By the end of the examination field work, the Company had reduced the outstanding net debit balance to an immaterial amount.

- b) The Company was unable to provide the examiners with signed and notarized copies of the 1996, 1997, 1998 and 1999 Regular Annual Statements.
- c) The results of the examination disclosed numerous internal control deficiencies, some of which are detailed in the "ACCOUNTS AND RECORDS" section of this report. Pursuant to RCW 48.05.280, the Company is required to ensure that all accounting controls be reviewed, and deficiencies identified and corrected.

2. Errors in Annual Statements

Review of the Company's Annual Statements for the period under examination disclosed several errors and/or omissions. RCW 48.05.250(1) states, "Each authorized insurer shall annually, before the first day of March, file with the commissioner a true statement of its financial condition, transactions, and affairs as of the thirty-first day of December preceding. The statement forms shall be in general form and context as approved by the National Association of Insurance Commissioners for the kinds of insurance to be reported upon and as supplemented for additional information required by this code and by the commissioner."

The Company is instructed to review and continue its efforts to substantially strengthen controls to comply with RCW 48.05.250(1) which requires the Company to file a true statement of its financial condition, transactions and affairs. The results of the examination disclosed the following errors in the Company's Annual Statements:

- a) On November 24, 1999, the Company transferred \$500,000 from paid in and contributed surplus to capital paid-up. The transfer increased capital paid-up from \$2,000,000 to \$2,500,000 and reduced the paid in and contributed surplus from \$5,000,000 to \$4,500,000. The Company failed to report the \$500,000 increase in capital paid-up and the \$500,000 reduction in paid in and contributed surplus in both the Capital and Surplus Account and in the Reconciliation of Ledger Assets of its 1999 Annual Statement.

- b) Exhibit 2 (Net Investment Income) in the Company's 2000 Annual Statement reported a negative \$7,756 in interest received on United States Government Bonds and \$1,382,959 in interest received on other bonds. The Company indicated that the negative \$7,756 in interest on United States Government Bonds should have been reported as \$192,111 and the \$1,382,959 in interest received on other bonds should have been reported as \$1,183,092.
- c) The Company did not list a number of insurance agencies in Schedule Y, Part 1, which conducted the business of insurance as listed under "AFFILIATED COMPANIES". The Company failed to include in its organizational chart SAFECO UK Limited and numerous insurance agencies which were owned either directly by SAFECO Corporation or by an affiliate. The NAIC Annual Statement Instructions indicate for Schedule Y, Part 1, that a chart or listing presenting the identities of and interrelationships between the parent, all affiliated insurers and other affiliates should be attached to the Annual Statement. See comments under "AFFILIATED COMPANIES" of this Report of Examination.

3. Incomplete Finance Committee Minutes

Quarterly minutes of the Company's Finance Committee covering the period from January 1, 1996 through December 31, 2000 were incomplete as the Company was unable to locate the February 5, 1996, August 5, 1996 and February 2, 1998 minutes covering the investment transactions for the last quarter of 1995, the second quarter of 1996 and the fourth quarter of 1997, respectively.

The Company is instructed to comply with RCW 48.13.340 which provides that no investment, sale or exchange shall be made by any domestic company unless authorized or approved by its Board of Directors or by a committee charged by the Board of Directors or the Bylaws with the duty of making such investment, sale or exchange, and with RCW 48.05.280 which provides that every insurer shall keep full and adequate accounts and records of its assets, obligations, transactions and affairs.

4. Short-Term Investments – Excess Loan to Affiliate

Schedule DA, Part 1 of the Company's 2000 Annual Statement reported a \$1,510,000 note receivable issued by SAFECO Insurance Company of America. There was no actual note in existence as of December 31, 2000 and the Company should not have reported the asset in Schedule DA. The loan, made under an Intercompany Loan Agreement, should have been reported as an asset under "Receivable from parent, subsidiaries and affiliates". Schedule DA, Part 1 reported an incorrect amount of \$151,000 for the asset rather than the correct amount of \$1,510,000.

The \$1,510,000 loan to SAFECO Insurance Company of America exceeded the limit prescribed by the Washington Insurer Holding Company Act, RCW 48.31B.030(1)(b)(i)(B) which limited the amount of a loan to 3% of the Company's prior year's admitted assets unless prior approval is granted by the Washington State Office of Insurance Commissioner (OIC). Prior approval was not obtained. As of December 31, 1999, the Company had \$18,852,539 in admitted assets

resulting in a maximum allowable loan of \$565,576 without prior approval. The \$1,510,000 loan was \$944,424 more than the \$565,576 allowed.

The Company is instructed to comply with RCW 48.31B.030(1)(b)(i)(B) which requires prior approval of all intercompany transactions which exceed 3% of the Company's prior year's admitted assets. Further, the Company is instructed to ensure compliance with all provisions of Chapter 48.31B RCW and is given notice of and subject to all applicable remedies contained in RCW 48.31B.050. The remedies and penalties under the code do not provide for non-admission of the asset, only cease and desist, avoidance of the transactions and possible monetary penalties.

5. Custodial Responsibilities

The confirmation of principal pay down securities received directly from Chase Manhattan Bank of New York (Chase) as of December 31, 2000, reported par values as of the time the securities were deposited with the bank rather than the amortized par values as of December 31, 2000. Since the information supplied by Chase could not be reconciled to the Company's records, the Company was asked to provide copies of the custodial statements listing the bank's amortized par values as of December 31, 2000. The Company indicated that the monthly statements prepared by Chase were received in electronic form and that the Company was unable to make copies as the information was encoded. Chase indicated that it was unable to provide listings of securities with the December 31, 2000 amortized par values.

The examination team informed the Company that the December 31, 2000 amortized par values must be reported in response to the confirmations. Direct confirmations listing the amortized par values of the securities as of December 31, 2000 were eventually prepared and received from Chase. The Company must require that its custodian(s) be able to produce accurate, reliable listings of all securities at amortized par value for purposes of accurate reconciliation and reporting.

The Company is instructed to comply with RCW 48.05.280 which provides that the Company keep full and adequate accounts and records of its assets, obligations, transactions and affairs.

6. Insurer Holding Company Act Violation

SAFECO Asset Management Company (SAM), an affiliate acquired by SAFECO Corporation in 1973, serves as the investment advisor for the Company and its affiliates. Numerous investment transactions were conducted between the Company and SAFECO Asset Management Company during the five year period under review for which no intercompany agreement was in force to define the rights and responsibilities and cost reimbursement methodologies.

These affiliate services performed by SAM are required to be "fair and reasonable" as to terms and charges pursuant to RCW 48.31B.030(1)(a)(i) and (ii). In addition, RCW 48.31B.030(1)(a) requires: "(iii) Expenses incurred and payment received must be allocated to the insurer in conformity with customary insurance accounting practices consistently applied; (iv) The books,

accounts, and records of each party to such transactions must be so maintained as to clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties.”

The Company is instructed pursuant to RCW 48.31B.030(1)(b)(iv) to submit for approval to the OIC an intercompany agreement with SAM and all pertinent affiliates which complies with RCW 48.31B.030(1)(a).

COMMENTS AND RECOMMENDATIONS

The examination developed the following comments and recommendations:

1. Investment Guidelines

The investment guidelines adopted by the Company on May 1, 2000 covered both the SAFECO Group of life companies and the SAFECO Group of property and casualty companies on a consolidated basis. Both the 2000 and 2001 investment guidelines had paragraphs that were incorrectly numbered or incomplete.

The Company adopted new investment guidelines effective January 1, 2002 that were correctly numbered; however, these guidelines were also on a consolidated basis for the life and property/casualty companies in the SAFECO Group. Before the January 1, 2002 investment guidelines were adopted, it was suggested to the Company that they be prepared on an individual company basis rather than on a consolidated basis. The consolidated guidelines adopted 2002 currently cover the SAFECO Group of companies that are domiciled in a number of different states and have different limitations for various assets. An example of the investment limitations on an individual company basis are contained in RCW 48.13.180 and RCW 48.13.273.

It is recommended the Company adopt individual investment guidelines that cover the investment requirements in the Washington Insurance Code.

2. Custodial Agreements

As of December 31, 2000, the Company’s securities were held by The Chase Manhattan Bank. The Company indicated that the securities held by The Chase Manhattan Bank were being held under an October 26, 1990 custodial agreement with the United States Trust Company of New York. The 1990 agreement had no provision for a successor. The Company had no documentation indicating that the 1990 agreement with the United States Trust Company of New York covered the securities held by The Chase Manhattan Bank. During the examination, the Company secured an October 11, 2001 letter from The Chase Manhattan Bank which indicated effective September 1, 1995, the United States Trust Company of New York merged with and into The Chase Manhattan Bank, N.A., which in turn merged with Chemical Bank and changed its name to The Chase Manhattan Bank and that by virtue of these mergers, The Chase Manhattan Bank has succeeded, by operation of law, to the rights, duties, and obligations of the

United States Trust Company of New York with respect to the October 26, 1990 custodial agreement.

It is recommended the Company review all custodial agreements to ensure the inclusion of a provision which provides for legal succession of all rights and responsibilities under the original custodial agreement.

HISTORY

SAFECO National Life Insurance Company was incorporated September 4, 1979 under the laws of the state of Washington and began active operations on September 5, 1979.

CAPITAL AND SURPLUS

As of December 31, 2000, the authorized capital stock of the Company consisted of 20,000 shares of common stock with a par value of \$125 per share, of which 20,000 shares were issued and outstanding. The following schedule summarizes the changes in the Company's capital and paid in surplus since the date of the last examination:

<u>Date</u>	<u>Authorized and Outstanding Shares</u>	<u>Par Value</u>	<u>Capital Paid-Up</u>	<u>Paid In and Contributed Surplus</u>
December 31, 1995	20,000	\$100	\$2,000,000	\$5,000,000
December 31, 2000	20,000	125	2,500,000	4,500,000

On November 17, 1999, Article VII of the Company's Articles of Incorporation was amended to increase the par value of the Company's 20,000 shares of authorized common stock from \$100 to \$125 a share and to increase the Company's paid in capital from \$2,000,000 to \$2,500,000. The \$500,000 increase in capital paid-up was accomplished by transferring \$500,000 from the Company's paid in and contributed surplus. The \$500,000 transfer reduced the Company's paid in and contributed surplus from \$5,000,000 to \$4,500,000. The amendment was filed with the OIC on November 24, 1999.

Dividends Paid to Shareholder

Dividends paid by the Company during the five-year period covered by this examination to the Company's parent, SAFECO Life Insurance Company, were as follows:

<u>Year</u>	<u>Dividends Paid To Shareholders</u>
1996	\$ 1,500,000
1997	1,500,000
1998	1,500,000
1999	1,400,000
2000	1,400,000

Dividends Paid to Policyholders

The Company paid no dividends to its policyholders during the five-year period under review.

MANAGEMENT AND CONTROL

Shareholder

The Company's outstanding shares were 100% owned by SAFECO Life Insurance Company, an insurance company incorporated under the laws of the state of Washington. SAFECO Life Insurance Company was a wholly owned subsidiary of SAFECO Corporation, an insurance holding company incorporated under the laws of the state of Washington.

SAFECO Corporation, directly or indirectly, owned the stocks of operating subsidiaries engaged in various phases of the insurance business and other financially related lines of business.

Board of Directors

The affairs of the Company were managed and its corporate powers were exercised by the authority of a nine member Board of Directors. The membership of the Board as of December 31, 2000, together with the city and state of residence and principal business or professional affiliation of each director, were as follows:

<u>Name/Address</u>	<u>Position(s)/Principal Affiliation(s)</u>
Donald Shelton Chapman Woodinville, Washington	Senior Vice President, Chief Operating Officer SAFECO Insurance Company of America (Commercial Insurance)
Boh Andrew Dickey Woodinville, Washington	President and Chief Operating Officer SAFECO Corporation

Board of Directors, Cont'd

Roger Harry Eigsti Seattle, Washington	Chairman and Chief Executive Officer SAFECO Corporation
Dale Ellis Lauer Woodinville, Washington	Senior Vice President SAFECO Insurance Company of America (American States Business Insurance)
William Thomas Lebo Lake Forest Park, Washington	Executive Vice President SAFECO Insurance Company of America
Rodney Allen Pierson Redmond, Washington	Senior Vice President, Chief Financial Officer, Secretary SAFECO Corporation
James Walter Ruddy Mercer Island, Washington	Senior Vice President, General Counsel SAFECO Corporation
Ronald Lee Spaulding Mill Creek, Washington	Treasurer and Chief Investment Officer SAFECO Corporation
Randall Howard Talbot Medina, Washington	President SAFECO Life Insurance Company

During January 2001, Roger Harry Eigsti and Boh Andrew Dickey resigned from the Board of Directors and Roger Floyd Harbin and Michael Sean McGavick were elected to the Board of Directors.

Officers

Officers of the Company as of December 31, 2000 were:

<u>Name</u>	<u>Position</u>
Randall Howard Talbot	President
Ronald Lee Spaulding	Treasurer and Vice President
Rodney Allen Pierson	Secretary and Vice President
Michael John Kinzer	Actuary and Vice President
Scott Lee Bartholomaus	Vice President
Leslie June Brandli	Vice President
Frank Gregory Clarke	Vice President
Stephen Dwight Collier	Vice President
Jennifer Victoria Davies	Vice President
Roger Floyd Harbin	Vice President

Officers, Cont'd

Michele Marie Kemper	Vice President
Homer Paul Lowber	Vice President
Steven Allen Manuel	Vice President
Patrick Bryan McCormick	Vice President
Michael Ray McLean	Vice President
Kimberly Elaine McSheridan	Vice President
Troy Olson-Blair	Vice President
George Christopher Pagos	Vice President
James Dwyer Pirak	Vice President
Craig James Schmidt	Vice President
Elizabeth Anne Sisti	Vice President
Paul Alexander Stevenson	Vice President
Malcolm Scott Taylor	Vice President
Sue Ellen Taylor	Vice President
Michael Rion Tucker	Vice President
James Lester Wilson	Vice President

Finance Committee

The Company's Finance Committee consisted of the following members as of December 31, 2000:

Roger Harry Eigsti – Chairman
Boh Andrew Dickey
Rodney Allen Pierson
Ronald Lee Spaulding

During January 2001, Roger Harry Eigsti and Boh Andrew Dickey resigned from the Finance Committee and Michael Sean McGavick was appointed as a member of the Finance Committee. The number of members on the Finance Committee was reduced from four to three members in 2001.

CONFLICT OF INTEREST

The Company had an operating procedure for disclosing conflicts of interest to the Board of Directors. Statements are circulated among the directors, officers and key employees every year as set forth in the Company's Policy of Ethical Standards, Conflicts of Interest and Compliance with Laws. The Company had a procedure for obtaining disclosure statements from new appointees during the interim.

A review of the completed statements disclosed that the directors, officers and key employees reported no conflicts of interest as of December 31, 2000.

AFFILIATED COMPANIES

The Company was a wholly-owned subsidiary of SAFECO Life Insurance Company. SAFECO Corporation was the ultimate controlling person. As a member of an Insurance Holding Company System, registration statements were required to be filed in accordance with RCW 48.31B.025 and WAC 284-18-300. SAFECO Corporation filed the registration statements for each year under examination on behalf of the Company, its parent company and its affiliated companies.

The following chart was taken from the SAFECO Corporation Organizational and Entity Chart:

SAFECO Corporation	100% Publicly Owned
SAFECO Financial Products, Inc.	100% SAFECO Corporation
SAFECO Insurance Company of Oregon	100% SAFECO Corporation
General America Corporation	100% SAFECO Corporation
Talbot Financial Corporation	100% General America Corporation
F. B. Beattie & Co., Inc.	100% General America Corporation
SAFECO Investment Services, Inc.	100% General America Corporation
SAFECO Select Insurance Services, Inc.	100% General America Corporation
R. F. Bailey Holding Limited	100% General America Corporation
General America Corporation of Texas – Attorney in Fact for:	100% General America Corporation
SAFECO Lloyds Insurance Company	Attorney in Fact
American States Lloyds Insurance Company	Attorney in Fact
First National Insurance Company of America	100% SAFECO Corporation
SAFECO Insurance Company of America	100% SAFECO Corporation
SAFECO Management Corporation	100% SAFECO Insurance Company of America
SAFECO Surplus Lines Insurance Company	100% SAFECO Insurance Company of America
Emerald City Insurance Agency, Inc.	100% SAFECO Insurance Company of America
SAFECO National Insurance Company (Missouri)	100% SAFECO Corporation
General Insurance Company of America	100% SAFECO Corporation
SAFECO Insurance Company of Pennsylvania	100% General Insurance Company of America
SAFECO Insurance Company of Illinois	100% SAFECO Corporation
Insurance Company of Illinois	100% SAFECO Insurance Company of Illinois
American States Insurance Company (Indiana)	100% SAFECO Corporation
American Economy Insurance Company (Indiana)	100% SAFECO Corporation
American States Insurance Company of Texas	100% American Economy Insurance Company
American States Preferred Insurance Company (Indiana)	100% SAFECO Corporation
SAFECO Credit Company Inc.	100% SAFECO Corporation
SAFECO Properties, Inc.	100% SAFECO Corporation
Winmar Company, Inc.	100% SAFECO Properties, Inc.
SAFECARE Company, Inc.	100% SAFECO Properties, Inc.
SAFECO Life Insurance Company	100% SAFECO Corporation

AFFILIATED COMPANIES, Cont'd

SAFECO National Life Insurance Company	100% SAFECO Life Insurance Company
American States Life Insurance Company	100% SAFECO Life Insurance Company
First SAFECO National Life Insurance Company of New York	100% SAFECO Life Insurance Company
D. W. Van Dyke & Co., Inc.	100% SAFECO Life Insurance Company
Medical Risk Managers, Inc.	15% SAFECO Life Insurance Company 85% D. W. Van Dyke & Co., Inc.
SAFECO Asset Management Company	100% SAFECO Corporation
Barrier Ridge LLC	100% SAFECO Corporation
SAFECO Services Corporation	100% SAFECO Corporation
SAFECO Securities, Inc.	100% SAFECO Corporation
SAFECO eCommerce, Inc.	100% SAFECO Corporation
SAFECO Trust Company	100% SAFECO Corporation
SAFECO UK Limited	100% SAFECO Corporation
SAFECO Administrative Services, Inc.	100% SAFECO Corporation
SAFECO Assigned Benefits Service Company	100% SAFECO Corporation

The Company failed to include in its organizational chart SAFECO UK Limited and numerous insurance agencies which were owned either directly by SAFECO Corporation or by an affiliate. The NAIC Annual Statement Instructions indicate for Schedule Y, Part 1, that a chart or listing presenting the identities of and interrelationships between the parent, all affiliated insurers and other affiliates should be attached to the Annual Statement. RCW 48.01.050 defined an insurer as every person engaged in the business of making contracts of insurance. The Company did not list the following insurance agencies in Schedule Y, Part 1 (shown below with the parent company relationship):

SAFECO Insurance Company of America
Emerald City Insurance Agency, Inc.
Puget Structured Benefit Agency, Inc.
SAFECO Select Insurance Services, Inc.
Pilot Insurance Services, Inc.
Talbot Agency, Inc.
Talbot Financial Services, Inc.
Talbot Insurance Agency of Alabama, Inc.
Talbot Insurance Agency of Texas, Inc.
Talbot Agency of Texas, Inc.
General America Corporation
F. B. Beattie & Company, Inc.
F. B. Beattie Insurance Services, Inc.
R. F. Bailey Holding Limited
R. F. Bailey (Underwriting Services) Limited
SAFECO Life Insurance Company
D. W. Van Dyke & Company, Inc.
Medical Risk Managers, Inc.

CORPORATE RECORDS

On November 17, 1999, Article VII of the Company's original Articles of Incorporation was amended by the sole shareholder to read, "The amount of capital stock shall be Two Million Five Hundred Thousand Dollars (\$2,500,000) and the number of shares shall be Twenty Thousand (20,000) and the par value of each of said shares shall be One Hundred Twenty Five Dollars (\$125)."

The amendment to the Company's Articles of Incorporation was filed with the OIC on November 24, 1999.

Minutes

The minutes of the Shareholder, Board of Directors and Finance Committee meetings for the period covered under the examination were reviewed. Investments were reviewed by the Finance Committee and the Finance Committee minutes were ratified by the Board of Directors; however, the minutes for three quarterly Finance Committee meetings were not located by the Company during the examination. Minutes reviewed indicated that the meetings were well attended and were in sufficient detail and substance to demonstrate that the Board of Directors was actively involved in the administration of the Company's affairs.

Contracts/Service Agreements

The following agreements were in force as of December 31, 2000:

1. Intercompany tax allocation agreement dated August 1, 1990. A consolidated return was filed by SAFECO Corporation with the companies included in Schedule Y of the Annual Statement in which there was an 80% or more ownership, except for American States Life Insurance Company. The allocation was based upon separate return calculations with current credit for net losses as such losses offset taxable income of other members of the consolidated group. Intercompany tax balances were settled quarterly.
2. Expense Sharing Agreement dated November 3, 1983. The Agreement covers payroll, use of real property, and miscellaneous expenses for sixteen stock companies within the SAFECO Group, which includes the six Washington domestic insurance companies. All of the companies are 100%-owned direct or indirect subsidiaries of SAFECO Corporation, the ultimate controlling person in the SAFECO holding company system.
3. The Company and twenty other affiliated companies in the SAFECO Group were named in an Intercompany Short-Term Borrowing Agreement effective November 15, 2000.

Intercompany Agreements should be used to document recurring transaction patterns between or among the SAFECO Group member companies. RCW 48.31B.030(1)(a)(iv), requires that records are to "...clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the

charges or fees...” An extensive volume of investment transactions were conducted between the SAFECO insurance companies and SAFECO Asset Management Company, but there was no intercompany agreement specifying the parties’ rights, duties and compensation. See item 6 under the “INSTRUCTIONS” portion of this Examination Report.

FIDELITY BONDS AND OTHER INSURANCE

The Company’s fidelity insurance was extended to the Company and its affiliated companies through a Financial Institution Bond issued to SAFECO Corporation, the Company’s parent, which provided coverage up to \$3,000,000 aggregate with no deductible. The affiliated companies carried excess insurance which provided an additional amount of coverage in layers through several carriers. The minimum amount of fidelity insurance coverage recommended by the NAIC for an insurance company of this size was \$1,000,000 to \$1,375,000. The minimum amount was met with the Financial Institution Bond and the excess insurance.

The Company was a named insured on various insurance policies issued to its ultimate parent, SAFECO Corporation, that provided protection against certain property and liability losses. Policies providing property coverage for buildings and contents, comprehensive commercial general liability and automobile bodily injury and property damage coverage were in effect during the period covered by this examination.

The Company was a named insured on a Directors and Officers Liability Policy with an authorized insurance carrier. Errors and Omissions coverage was also provided under this policy.

OFFICERS’, EMPLOYEES’ AND AGENTS’ WELFARE AND PENSION PLANS

The employees of the SAFECO Group of property/casualty and life companies were treated as employees of SAFECO Insurance Company of America. The salaries and benefits paid or accrued to these employees were allocated and prorated to the various companies in the Group based on the intercompany pooling agreement and other intercompany arrangements.

The SAFECO Group had the following benefit plans available to officers, employees and their dependents: Group Life Insurance, Accidental Death and Dismemberment, Long-term Disability, Medical and Dental. The SAFECO Group contributes to the Life, Medical and Dental plans.

The SAFECO Group had the following retirement and profit sharing plans:

1. **Cash Balance Plan** – A defined contribution plan established during 1989. The plan provided an annual credit to each employee’s account, regardless of profitability of the SAFECO Group. The amount was 3% of eligible compensation paid each year to the participants. The participant’s balances were credited with interest at a rate of 5%.

2. **Profit Sharing Bonus** – A cash bonus was paid to the salaried employees who had completed one calendar year of service. Each year 10% of the “adjusted underwriting profit” of the SAFECO Group earned during the previous year was allocated to the profit sharing bonus plan. A cash bonus was then paid to the eligible employees based on a percentage of the previous year’s base salary. An employee with three or more calendar years of service could receive a maximum cash bonus of 10% of his or her previous year’s salary.
3. **Profit Sharing Retirement Plan** – A defined contribution plan where contributions are based on the SAFECO Group’s profit, 5% of net profit, before taxes and stockholder’s dividends and after subtracting an amount credited to the Cash Balance Plan. The maximum contribution to the trust shall not exceed 12% of eligible compensation paid each year to the participants.
4. **Employees’ Savings Plan** – A defined contribution plan was established during 1967. The plan was available to an employee after 12 calendar months of service. An employee could save up to 6% of basic salary. The companies contributed an amount equal to two-thirds of the employee’s deduction.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2000, the Company was authorized to transact business in the following thirty-nine states and the District of Columbia:

Alabama	Kentucky	Ohio
Arizona	Louisiana	Oklahoma
Arkansas	Maryland	Oregon
California	Michigan	Pennsylvania
Colorado	Minnesota	South Carolina
Connecticut	Mississippi	South Dakota
Delaware	Missouri	Tennessee
Florida	Montana	Texas
Georgia	Nebraska	Utah
Idaho	Nevada	Virginia
Illinois	New Mexico	Washington
Indiana	North Carolina	West Virginia
Kansas	North Dakota	Wisconsin

The Company wrote no new business during the five-year period under review.

GROWTH OF COMPANY

The growth of the Company for the past five years is reflected in the following exhibit, prepared from copies of the filed Annual Statements:

<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Capital</u>	<u>Surplus</u>	<u>Premiums and Annuity Consideration</u>
2000	\$18,252,619	\$4,499,696	\$2,500,000	\$11,252,923	\$576,740
1999	18,852,539	4,502,997	2,500,000	11,849,542	588,970
1998	19,169,784	4,474,937	2,000,000	12,694,847	620,663
1997	19,865,778	4,692,627	2,000,000	13,173,151	676,003
1996	19,385,706	4,122,210	2,000,000	13,263,496	711,516

REINSURANCE

The Company did not cede or assume any business during the examination period.

ACCOUNTS AND RECORDS

The external audit firm of Ernst and Young LLP was retained by the Company to audit the Company's statutory financial statements for the years under examination. Reports for 1999 and 2000 were provided as well as the work papers for 2000. As part of the audit work papers, the internal control structure noted deficiencies in the timely preparation of bank reconciliations and the clearance of items listed on the reconciliations.

The Internal Audit Department of the parent company, SAFECO Corporation, performed audits of the Company and provided recommendations to management on internal controls and operational procedures.

The Examiners independently tested internal controls and the following significant weaknesses were found:

1. Cash – A number of instances were noted in which the cash administrative data base contained erroneous or incomplete information. This condition resulted from the opening or amendment of bank accounts by parties other than those in the central bank administration department. Company employees should be made aware that only the bank administration department can open or change bank accounts.
2. Short-Term Investments – Included in this asset were intercompany loans. These loans were made under a written agreement and were termed "Notes Receivable" in the Annual Statements. The loans were not supported by individual notes. The terminology should be changed to accurately describe the respective loans and notes should be executed for each loan.

During the examination, the Company engaged an external firm to guide and oversee resolving the many cash and other account reconciliations that had been in process for years and to put in place new procedures and controls.

OIC Actuarial Review

The life actuary from the OIC reviewed the Company's reserves as of December 31, 2000. The review was done concurrently with the reserves of the Company's parent, SAFECO Life Insurance Company.

An incorrect factor was being used by the Company in the calculation of its traditional life business. The factor implicitly assumed that the average issue date within a month was at month-end, instead of appropriately assuming that the average date issued within a month was the middle of the month. No adjustments were necessary as the incorrect factor resulted in a more conservative reserve.

Electronic Data Processing System

The management of the Company had sufficient knowledge of electronic data processing issues and provided direction and oversight through its Business Application Groups. Systems development, acquisition and maintenance controls were evaluated to gain assurance that programs and systems were designed, tested, approved and implemented using appropriate controls. The internal controls in place provided for the proper separation of duties.

Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed and the controls exercised to maintain data security. Adequate procedures and controls were in place for mainframe and network operations.

CONTINGENT LIABILITIES AND LEASES

The Company had no material contingent liabilities or leases as of December 31, 2000.

SUBSEQUENT EVENTS

1. On December 20, 2002, the OIC issued Order No. 99 granting approval of a special consent investment. The Order, effective December 31, 2000, gave the Company special consent to acquire and hold foreign securities in excess of the limitations contained in RCW 48.13.030 and RCW 48.13.180. The Order provided that the investments authorized by this Order may be credited to the Company's minimum capital or surplus or required reserves pursuant to RCW 48.13.250. The investments authorized by the Order shall be

eligible for classification as admitted assets of the Company. The Order indicated that the Company desired to be in compliance with the OIC's interpretation of the Code, and so intends to divest itself of these foreign securities no later than November 15, 2004, unless before that time the investments attain the standard of eligibility. The Company had no investment in foreign securities as of December 31, 2000; however, it did acquire a foreign security in 2001.

2. The NAIC adopted Statements of Statutory Accounting Principles (Codification) effective January 1, 2001. The effect of Codification resulted in a \$71,359 increase in the Company's 2001 statutory surplus.
3. The Company paid its shareholder, SAFECO Life Insurance Company, \$1,350,000 in dividends in 2001 and \$1,350,000 in dividends in 2002.
4. On November 8, 2001, the Company's Bylaws were amended to revise the Regular Meeting verbiage. The reference to a specific meeting date each quarter was removed and replaced with wording that requires a quarterly meeting on a date and place to be specified. This amendment was made to allow the Board of Directors more flexibility and places the Company's Bylaws in compliance with the other insurance companies within the SAFECO Group.

FINANCIAL STATEMENTS

The following statements, with the exception of the Five Year Reconciliation of Capital and Surplus as stated by the Company, reflect the financial condition of the Company as of December 31, 2000 as determined by this examination:

Balance Sheet
As of December 31, 2000

Summary of Operations
For the Year Ended December 31, 2000

Capital and Surplus Account
For the Year Ended December 31, 2000

Reconciliation of Capital and Surplus
For the Five Year Examination Period (Per Company)

SAFECO NATIONAL LIFE INSURANCE COMPANY
Balance Sheet
As of December 31, 2000

	<u>BALANCE PER COMPANY</u>	<u>NOTES</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
<u>ASSETS</u>				
Bonds	\$ 15,602,112		\$ -	\$ 15,602,112
Stocks:				
Preferred stocks	481,952			481,952
Policy loans	183,356			183,356
Cash and short-term investments	1,527,529	1		1,527,529
Guaranty funds receivable	4,527			4,527
Life premiums and annuity considerations				
deferred and uncollected on in force business	104,195			104,195
Investment income due and accrued	346,686			346,686
Receivable from parent, subsidiaries and affiliates	<u>2,262</u>		<u>-</u>	<u>2,262</u>
Total Assets	<u>\$ 18,252,619</u>		<u>\$ -</u>	<u>\$ 18,252,619</u>

SAFECO NATIONAL LIFE INSURANCE COMPANY
Balance Sheet
As of December 31, 2000

	<u>BALANCE</u> <u>PER COMPANY</u>	<u>NOTES</u>	<u>EXAMINATION</u> <u>ADJUSTMENTS</u>	<u>BALANCE PER</u> <u>EXAMINATION</u>
<u>LIABILITIES</u>				
Aggregate reserve for life policies & contracts	\$ 4,108,921		\$ -	\$ 4,108,921
Policy and contract claims:				
Life	19,000			19,000
Premiums received in advance	4,920			4,920
Liability for premium and other deposit funds:				
Policyholder premiums	658			658
Policy and contract liabilities not included elsewhere:				
Interest maintenance reserve	81,192			81,192
Commissions to agents due or accrued	132			132
Taxes, licenses and fees (excluding federal and foreign income taxes)	14,103			-
Federal income taxes due and accrued	132,956			132,956
Unearned investment income	7,199			7,199
Amounts withheld or retained by company as agent or trustee	944			944
Amounts held for agents' account	228			228
Remittances and items not allocated	(3,404)			(3,404)
Asset valuation reserve	96,170			96,170
Payable to parent subsidiary and affiliates	31,949			31,949
Payable for securities	4,582			4,582
Aggregate write-ins for liabilities	146		-	146
	<u> </u>		<u> </u>	<u> </u>
Total Liabilities	<u>\$ 4,499,696</u>		<u>\$ -</u>	<u>\$ 4,499,696</u>
<u>CAPITAL AND SURPLUS</u>				
Common capital stock	\$ 2,500,000		\$ -	\$ 2,500,000
Gross paid in and contributed surplus	4,500,000			4,500,000
Unassigned funds (surplus)	6,752,923		-	6,752,923
	<u> </u>		<u> </u>	<u> </u>
Total Capital and Surplus	<u>\$ 13,752,923</u>		<u>\$ -</u>	<u>\$ 13,752,923</u>
	<u> </u>		<u> </u>	<u> </u>
Total Liabilities, Capital and Surplus	<u>\$ 18,252,619</u>		<u>\$ -</u>	<u>\$ 18,252,619</u>

SAFECO NATIONAL LIFE INSURANCE COMPANY
Summary of Operations
For the Year Ended December 31, 2000

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION
Premiums and annuity considerations	\$ 576,740	\$ -	\$ 576,740
Net Investment Income	1,495,817		1,495,817
Amortization of interest maintenance reserve	18,496		18,496
Aggregate write-ins for miscellaneous income	106,250	-	106,250
Total Income	\$ 2,197,303	\$ -	\$ 2,197,303
Death benefits	\$ 247,318	\$ -	\$ 247,318
Disability benefits	11,958		11,958
Surrender benefits and other fund withdrawals	71,516		71,516
Interest on policy and contract funds	6,036		6,036
Increase in aggregate reserves for life and accident and health policies and contracts	166,353		166,353
Commissions on premiums and annuity considerations	5,613		5,613
General insurance expenses	91,121		91,121
Insurance taxes, licenses and fees	54,827		54,827
Increase in loading on and cost of collection	1,737	-	1,737
Total Benefits and Expenses	\$ 656,479	\$ -	\$ 656,479
Net Gain from Operations before div. to policyholders	\$ 1,540,824	\$ -	\$ 1,540,824
Dividends to policyholders	-	-	-
Net gain from operations before federal income taxes	\$ 1,540,824	\$ -	\$ 1,540,824
Federal income taxes incurred	528,474	-	528,474
Net gain from operations before realized capital gains	\$ 1,012,350	\$ -	\$ 1,012,350
Net realized capital gains	(267,245)	-	(267,245)
Net Income	\$ 745,105	\$ -	\$ 745,105

SAFECO NATIONAL LIFE INSURANCE COMPANY
Capital and Surplus Account
For the Year Ended December 31, 2000

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
<u>CAPITAL AND SURPLUS ACCOUNT</u>			
Capital and surplus, December 31, prior year	\$ 14,349,541	\$ -	\$ 14,349,541
Net income	\$ 745,105	\$	\$ 745,105
Change in non-admitted assets and related items	(4,592)		(4,592)
Change in asset valuation reserve	62,869		62,869
Dividends to stockholders	(1,400,000)	-	(1,400,000)
 Net change in capital and surplus for the year	 \$ (596,618)	 \$ -	 \$ (596,618)
 Capital and Surplus, December 31, Current Year	 <u>\$ 13,752,923</u>	 <u>\$ -</u>	 <u>\$ 13,752,923</u>

SAFECO NATIONAL LIFE INSURANCE COMPANY
Reconciliation of Capital and Surplus
For the Five Year Examination Period
(Per Company)

	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Capital and Surplus, December 31, Previous Year	\$ 14,349,541	\$ 14,694,847	\$ 15,173,151	\$ 15,263,496	\$ 15,521,798
Net income	\$ 745,105	\$ 1,120,771	\$ 1,011,842	\$ 1,321,749	\$ 1,248,746
Change in non-admitted assets	(4,592)		13	544	(2)
Change in asset valuation reserve	62,869	(66,077)	9,841	87,362	(7,046)
Dividends to stockholders	<u>(1,400,000)</u>	<u>(1,400,000)</u>	<u>(1,500,000)</u>	<u>(1,500,000)</u>	<u>(1,500,000)</u>
 Net change in capital and surplus	 \$ (596,618)	 \$ (345,306)	 \$ (478,304)	 \$ (90,345)	 \$ (258,302)
 Capital and Surplus, December 31, Current Year	 <u>\$ 13,752,923</u>	 <u>\$ 14,349,541</u>	 <u>\$ 14,694,847</u>	 <u>\$ 15,173,151</u>	 <u>\$ 15,263,496</u>

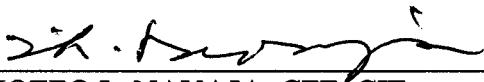
NOTES TO FINANCIAL STATEMENTS

1. Cash and Short-Term Investments - The Company reported an investment of \$1,510,000 in the short-term notes issued by SAFECO Insurance Company of America. The \$1,510,000 loan to the Company's affiliate exceeded the limit prescribed by the Washington Insurer Holding Company Act, RCW 48.31B.030(1)(b)(i)(B) which limited the amount of a loan to 3% of the Company's prior year's admitted assets. As of December 31, 1999, the Company had \$18,852,539 in admitted assets resulting in a maximum allowable loan of \$565,576. The \$1,510,000 loan was \$944,424 more than the \$565,576 allowed. The Company was instructed to comply with the remedies contained in RCW 48.31B.050(3). The remedies and penalties under the code do not provide for non-admission of the asset, only cease and desist, avoidance of the transaction and possible monetary penalties. See "INSTRUCTIONS" No. 4, Short-Term Investments – Excess Loan to Affiliate.

ACKNOWLEDGMENT

Examiners John J. Gaynard, CPA, CPCU, AFE; Peter M. Mendoza, CFE, CIE; Orlando R. Gabriel, Kehinde Ovbiebo, Constantine Arustamian, CPA; Mike Bosley, CPA; Charles J. Mitchell, CPA; Mitch Coe, CPA; Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner and Alexis S. Santos, FSA, MAAA, Associate Actuary, from the Washington State Office of Insurance Commissioner and Larry E. Cross, CFE, CIE, from the state of Delaware participated in the examination and preparation of this report.

Respectfully submitted,



TIMOTEO L. NAVAJA, CFE, CIE
Examiner-in-Charge
Office of Insurance Commissioner
State of Washington



RICHARD A. RANDOUR, CFE, CPA
Representing State of Delaware and
NAIC Northeastern Zone

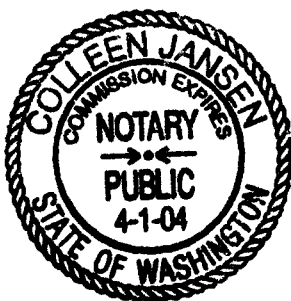


ROBERT E. VOLKER, CFE, CIE
Representing State of Nevada and
NAIC Western Zone

STATE OF WASHINGTON)
) ss
COUNTY OF KING)

He attests that the examination of SAFECO National Life Insurance Company was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Subscribed and sworn to before me on this 11th day of September, 2003.



Colleen Jensen
Notary Public in and for the
State of Washington,
Residing at Seattle.
My commission expires 4/1/04.